United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

ORIGINAL 75-7013

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P/S

United States Court of Appeals

For the Second Circuit.

SECURITIES AND EXCHANGE COMMISSION,
Plaintiffs-Appellee,

-against-

CAPITAL GROWTH COMPANY, S.A. (Costa Rica) CAPITAL GROWTH COMPANY, S.A. (Panama) NEW PROVIDENCE SECURITIES LTD., S.A. SHEFFIELD ADVISORY COMPANY, SHEFFIELD ADVISORY COMPANY, S.A., EHG ENTERPRISES, INC., CLOVIS W. McALPIN, SANFORD C. SHULTES, ARIEL E. GUTIERREZ and ENRIQUE H. GUTIERREZ,
Defendants,

ARIEL E. GUTIERREZ, ENRIQUE H. GUTIERREZ and EHG ENTERPRISES INC.,
Defendants-Appellants.

On Appeal From The United States District Court
For The Southern District Of New York

Appellants' Brief

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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SECURITIES AND EXCHANGE COMMISSION

DOCKET NO. 75-7013

Plaintiff-Appellee,

-against-

CAPITAL GROWTH COMPANY, S.A. (Costa Rica), CAPITAL GROWTH COMPANY, S.A. (Panama), NEW PROVIDENCE SECURITIES LTD. S.A. SHEFFIELD ADVISORY COMPANY, SHEFFIELD ADVISORY COMPANY, S.A., EHG ENTERPRISES Inc., CLOVIS W. McALPIN, SANFORD C. SHULTES, ARIEL E. GUTIERREZ and ENRIQUE H. GUTIERREZ

Defendants,

ARIEL E. GUTIERREZ, ENRIQUE H. GUTIERREZ and EHG ENTERPRISES INC.,

Defendants-Appellants.

----------x

BRIEF OF DEFENDANTS-APPELLANTS

STATEMENT

The defendants-appellants, ARIEL E. GUTIERREZ, ENRIQUE H. GUTIERREZ and EHG ENTERPRISES INC., *appeal from that part of the order of United States District Judge

*For purposes of convenience said defendants-appellants will be referred to as the EHG GROUP, and the plaintiff-appellee as SEC or COMMISSION.

CHARLES E. STEWART, JR. contained in the transcript of the minutes of the hearing of November 25, 1974, (107A-109A), * as denied their application to vacate the preliminary injunction and the appointment of a Receiver with respect to them pursuant to the order of United States District Judge CHARLES E. STEWART, JR., dated September 24, 1974. The EHG GROUP did not participate in the proceedings leading to the order of September 24, 1974. These proceedings took place on September 3, 1974, September 4, 1974, and September 13, 1974. It was on September 13, 1974, that the Court granted the application of the COMMISSION for a preliminary injunction and the appointment of a Receiver (59A-60A; 61A-62A) although the order itself was not signed until September 24, 1974. The reason for the delay was to find a receiver to be included in the injunctive order (116A, footnote 3). The EHG Group was not personally served with copies of the summons and complaint until September 19, 1974, in Puerto Rico where they live and operate their business (96A; E234-E235).

The basis of the Court's denial of said application of the EHG GROUP is set forth in its "So-Ordered" Memorandum dated December 31, 1974, (123A-131A) subsequent to the date of the notice of appeal herein, December 23, 1974, served and filed December 26, 1974.

*Page references followed by the letter A refer to the Appendix.
Page references preceded by the letter E refer to the Exhibit Book.

jurisdiction over the defendant(s). Although

The defendants, CAPITAL GROWTH COMPANY, S.A. (COSTA RICA), CAPITAL GROWTH COMPANY, S.A. (PANAMA), NEW PROVIDENCE SECURITIES LTD. S.A. and CLOVIS W. McALPIN, have failed to appear in the action and are in default.

The defendants, SHEFFIELD ADVISORY COMPANY, SHEFFIELD ADVISORY COMPANY, S.A. and SANFORD C. SHULTES, have consented to the entry of final judgments of permanent injunction against them.

STATUTES INVOLVED

15 U.S.C. 78j(b) (Section 10 (b) of the Securities Exchange Act of 1934, so far as pertinent, provides as follows:

> "It shall be unlawful for any person directly or indirectly, by the use of anymeans or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange -
>
> * * * * * * * * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commissionmay prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 (17 CFR 240. 10b-5) provides as follows:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
> (a) To employ any device, scheme, or artifice to defraud,
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

15 U.S.C. 78u(e) (Section 21(e) of the Exchange Act) so far as pertinent, provides as follows:

> "Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this chapter, or of any rule or regulation thereunder, it may in its discretion bring an action in the proper district court of the United States or the United States courts of any Territory or other place subject to the jurisdiction of the United States to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. ****"

15 U.S.C. 78 aa (Section 27 of the Exchange Act), so far as pertinent, provides as follows:

> "The district courts of the United States, and the United States Courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity or actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. * * * ~~* * Any~~ suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or wherever the defendant may be found."

Rule 65 of the Federal Rules of Civil Procedure so far as pertinent, provides as follows:

> "(a) Preliminary Injunction
> (1) Notice. No preliminary injunction shall be issued without notice to the adverse party.
>
> * * * * * * * * * * * * * * *
>
> (d) Form and Scope of Injunction or Restraining Order. Every order granting and injunction and every restraining order shall set forth the reasons for its issuance; shall be specific in terms, shall describe in reasonable detail, and not by reference to the complaint or other document, the act or acts sought to be restrained; and is binding only upon the parties to the action, their officers, agents, servants, employees, and attorneys, and upon those persons in active concert or participation with them who receive actual notice of the order by personal service or otherwise."

Nor did the Court rely on a telephone call to the defendant,

ISSUES PRESENTED FOR REVIEW

1. Did the Court below have jurisdiction of the persons of the EHG GROUP when it granted the application of SEC on September 13, 1974, for a preli minary injunction and the appointment of a Receiver at which time the EHG GROUP had not been served with a copy of the summons and complaint in the action?

2. Did the COMMISSION establish a proper case against the EHG GROUP for the issuance of a preliminary injunction and the appointment of a Receiver?

STATEMENT OF THE CASE

The complaint in this action instituted by the COMMISSION against the ten defendants named therein including the three defendants comprising the EHG GROUP, alleges that said defendants have engaged, are engaged and are about to engage in acts and practices in violation of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 CFR 240.10b-5, and unless restrained and enjoined will continue to engage in such acts and practices (4A). Said complaint was filed with the Clerk of the District Court and a summons issued by said Clerk on September 3, 1974 (1A, 92A).

The District Court at one point comes to that conclusion

That same date, September 3, 1974, at about 4:30 P. M. a hearing was held before United States District Judge CHARLES E. STEWART, JR. in connection with an order to show cause for a preliminary injunction, appointment of a Receiver, and the entry of a temporary restraining order, pending the hearing for the preliminary injunction and the appointment of a Receiver. The COMMISSION was represented by Counsel as well as the defendants, SHEFFIELD ADVISORY COMPANY, SHEFFIELD ADVISORY COMPANY, S.A., and SANFORD C. SHULTES (49A).

The COMMISSION already was aware that Stroock, Stroock & Lavan, Esqs. who had represented the EHG GROUP in previous SEC matters were not representing them in this action. The EHG GROUP was not notified of the hearing (50A-52A).

The Court signed the order to show cause and temporary restraining order on September 3, 1974, at 5:30 P. M. (20A-26A).

The order to show cause further provided that duly conformed copies thereof and the temporary restraining order and the papers upon which it was granted, be served upon the various defendants by September 4, 1974 at 5 P. M. in the different ways provided therein (24A-26A).

The EHG GROUP was to be served by delivery of a copy to Stroock, Stroock & Lavan, Esqs., attention of Laurence Greenwald, Esq., 61 Broadway, New York, New York, and in addition by certified mail, return receipt requested, to the offices of EHG ENTERPRISES, INC., El Caribe Building, corner of Palmeras and Jeronimo, San Juan, Puerto Rico (25A).

The members of the EHG GROUP lived and were in business in San Juan, Puerto Rico.

At the resumed hearing of September 4, 1974, the COMMISSION advised the Court that it had been in contact with ARIEL GUTIERREZ (presumably by telephone) the evening of September 3, 1974, and had communicated again with Stroock, Stroock & Lavan, Esqs. on September 4, 1974, who repeated they were not engaged to represent the EHG GROUP as attorneys. This information was furnished the COMMISSION by telephone and letter (57A, 94A).

Apparently, on September 4, 1974, the COMMISSION mailed duly conformed copies of the order by certified mail, return receipt requested, to the EHG GROUP in San Juan, Puerto Rico (94A,E320).

At the hearing on the return day of the order to show cause, September 13, 1974, at which date the COMMISSION

Such facts are in no way analogous to the present

proposed the entry of the preliminary injunction and the appointment of a Receiver, the EHG GROUP did not appear personally nor by attorney (59A-60A). The COMMISSION submitted an order to the Court for a preliminary injunction and the appointment of a Receiver and informed the Court it would shortly present proposed findings of fact and conclusions of law "to underline the entry of this order" (61A-62A). The order was not actually signed by the Court until September 24, 1974 (67A-71A), only because of the delay in finding a receiver (116A, footnote 3). According to the COMMISSION copies of the preliminary injunction and appointment of a Receiver were mailed to the EHG GROUP in Puerto Rico on September 25, 1974 (95A).

Copies of the summons and complaint in the action were served on the EHG GROUP in person in Puerto Rico on September 19, 1974 (96A) apparently together with the previously referred papers in the action (77A).

Although on or about October 18, 1974 present counsel for the EHG GROUP met with representatives of the COMMISSION at its office, the parties could not agree as to the terms

of a stipulation extending the time of the EHG GROUP to answer the complaint and what action should be taken regarding the preliminary injunction (77A-78A, 96A, 98A-100A).

The EHG GROUP by notice of motion dated October 30, 1974, returnable November 14, 1974, applied to the Court below for an order to quash service, vacate the preliminary injunction and appointment of a Receiver, to set aside the default and to extend their time to plead or answer (72A-81A). The application was supported by the affidavit of ARIEL E. GUTIERREZ sworn to October 30, 1974 (82A-91A).

A hearing was held on the application on November 25, 1974, at which time the Court below granted the application of the EHG GROUP to serve and file their answer to the complaint but denied the application to vacate the preliminary injunction and the appointment of a Receiver (107A-108A).

The answer of the EHG GROUP to the complaint was served on the COMMISSION on November 25, 1974, and filed with the Clerk of the District Court on November 26, 1974 (3A). The answer denies the material allegations of the complaint that the EHG GROUP violated Section 10(b) of the Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5, 17 CFR 240.10b-5. It also alleges various affirmative defenses (110A-112A).

Thereafter, the Court on December 31, 1974, in a "So Ordered" Memorandum (113A-131A) set forth its findings of fact and conclusions of law, as to all the defendants in the action, including the basis of its denial of the EHG GROUP application to vacate the preliminary injunction and the appointment of a Receiver (123A-131A).

Prior thereto on December 26, 1974, the EHG GROUP served and filed its notice of appeal from that part of the order of the Court below set forth in the transcript of the hearing of November 25, 1974 denying their application to vacate the preliminary injunction and the appointment of a Receiver.

Further reference to the facts, particularly as to the merits involved in granting the preliminary injunction against the EHG GROUP will be made in connection with the points of law raised.

THE LAW

POINT I

THE DISTRICT COURT DID NOT HAVE IN PERSONAM JURISDICTION OF THE DEFENDANTS, EHG GROUP, WHEN IT GRANTED THE APPLICATION OF SEC FOR AN ORDER FOR A PRELIMINARY INJUNCTION AND THE APPOINTMENT OF A RECEIVER, THEREBY RENDERING SAID ORDER VOID AS TO SAID DEFENDANTS.

This action was commenced on September 3, 1974, when the Commission filed its complaint with the Clerk of the United States District Court for the Southern District of New York, and the Clerk issued a summons simultaneously. In order for the Court to obtain jurisdiction in person over the defendants named in the summons and complaint, and this brief is concerned only with the EHG GROUP, the defendants must be served with copies of the summons and complaint. The defendants, EHG Enterprises Inc., Ariel E. Gutierrez and Enrique H. Gutierrez, who comprise the EHG GROUP, were served with copies of the summons and complaint in Puerto Rico on September 19, 1974 (96A; E234-E235).

This is true of all civil actions instituted in the United States District Courts whether the plaintiff is the Securities and Exchange Commission, or any other governmental agency or private party.

Simultaneously, on September 3, 1974, the Commission by order to show cause signed 5:30 P.M. (26A) returnable September 13, 1974 at 10:00 A.M., moved for a preliminary injunction and the appointment of a receiver. A temporary restraining order was contained in said order to show cause pending the determination of the application for the preliminary injunction and the appointment of a receiver.

The order to show cause provided that a copy thereof and the papers upon which it was based, should be served upon the EHG GROUP by service of same upon Stroock, Stroock & Lavan, Esqs., whom the Commission and the Court by that time knew were denying they represented the defendants in the action, and upon the EHG GROUP in Puerto Rico, certified mail, return receipt requested.

Hearings were held before the District Court on both September 3, 1974, and September 4, 1974, regarding the temporary restraining order, at neither of which was the EHG GROUP represented (50A-52A, 57A). According to Richard L. Jaeger, Esq., one of the Commission attorneys, Stroock, Stroock & Lavan, Esqs., were notified of the application for a temporary restraining order as a matter of courtesy (52A) because that law firm had previously represented the defendants. By September 4, 1974, the Commission had written confirmation from Stroock, Stroock & Lavan, Esqs., that they had not been retained

in the action (94A).

It is a matter of some significance that during the period from September 3, 1974, when the complaint was filed and the order to show cause was signed, and September 13, 1974, the return date of the order to show cause, no effort of any kind was made by SEC to serve copies of the summons and complaint upon the defendants, EHG GROUP, in Puerto Rico. On September 17, 1974, copies of the summons and complaint were hand delivered to Eduardo Castillo Blanco, Esq., a Puerto Rican attorney for service upon the defendants, EHG Enterprises Inc., Ariel E. Gutierrez and Enrique H. Gutierrez, which said attorney served upon them personally on September 19, 1974, in San Juan, Puerto Rico (E324-E325).

It is common knowledge that flying time between the City of New York and San Juan, Puerto Rico, is three and one-half hours. If the SEC seriously contemplated service of the summons and complaint upon the EHG GROUP, it could have done so many times over during the period from September 3, 1974, to September 13, 1974. However, the position of the Commission apparently is that notice of a pending application for a preliminary injunction confers personal jurisdiction upon the Court of the defendants regardless of the nature or type of notice given, or that personal jurisdiction is not necessary for

the issuance of a preliminary injunction (page 26, minutes of hearing of November 25, 1974; 128 A-129A).

On September 13, 1974, the return date of the application for the preliminary injunction and the appointment of a receiver, the Commission appeared before the District Court for the relief prayed for against seven "defaulting" defendants including the EHG GROUP (59A-60A). The Commission submitted to the Court an order for a preliminary injunction and the appointment of a receiver (61A). The Commission intended to submit to the Court proposed findings of fact and conclusions of law "to underline the entry of this order" (62A). It is quite obvious from reading the minutes of the hearing of September 13, 1974 that the Court granted the application for a preliminary injunction and the appointment of a receiver against the seven named defendants including the EHG GROUP (59A), but delayed signing the order until September 24, 1974, because of its difficulties in finding a suitable receiver.

The EHG GROUP contends that it was deprived of jurisdictional due process when on September 13, 1974, the District Court granted the application of the Commission for a preliminary injunction against it. It is the position of said

defendants that no matter what the form or nature of the notice given them, such notice alone could not give the Court in personam jurisdiction to grant a preliminary injunction in the absence of service of the summons and complaint upon them. This is not a technical argument as urged by the Commission at the oral hearing on November 25, 1974, to vacate the preliminary injunction and the appointment of a receiver (minutes of hearing of November 25, 1974, page 18), and as asserted by the District Court in its "So Ordered" Memorandum dated December 31, 1974 (128 A).

The application for a preliminary injunction was made pursuant to Rule 65 of the Federal Rules of Civil Procedure.

As stated in Moore's Federal Practice, Second Edition, Volume 7, par. 65.03 [3], page 65-29:

> "It has been pointed out that Rule 65 is a procedural rule; that the federal injunctive remedy is subject is (to) jurisdictional and other regulatory statutes and judicial principles; and that Rules 65 confers no jurisdiction."

The author comments further concerning jurisdiction of the persons of the defendants in the same paragraph (65.03 /3/) as follows at page 65-31:

"We turn now to the necessity of obtaining jurisdiction over the defendant(s). Although in some situations an injunction, when granted, may have an in rem effect, the general nature of an action or proceeding for an injunction is in personam and hence the court must have in personam jurisdiction over the party against whom the injunction runs. Where such a party is a defendant, jurisdiction over the defendant implies either voluntary appearance by him or effective service of process."

The EHG GROUP has not appeared voluntarily in the action and there was no effective service of process upon them on September 13, 1974. As a matter of fact said defendants in their answer allege as part of their Third Affirmative Defense that the District Court lacked jurisdiction over their persons (111A).

With respect to the necessary notice required for the issuance of a preliminary judgment against an adverse party under Rule 65 (a) of the Federal Rules of Civil Procedure, it is stated in Moore's Federal Practice, Second Edition, Volume 7, par. 65.04 (3), pages 65-56, as follows:

"Proper service of the summons and complaint upon a party or a proper agent of the adverse party and notice of the time when and place at which the plaintiff will apply for a temporary injunction are sufficient. The notice requirement of Rule 65 (a) does not, however, necessitate, per se, subpoena, summons, writ or other legal process. But a court must have in personam jurisdiction over a party before

Certainly, the Commission has not met the [illegible]

> it can validly enter either an interlocutory or final judgment against him and mere notice will not suffice to obtain jurisdiction over a defendant" (Emphasis added).

Federal Practice and Procedure, Wright and Miller, Volume 11, Section 2941, page 362, is to the same effect:

> "In keeping with its procedural function, Rule 65 does not confer either subject matter or personal jurisdiction on the Court. As is true of civil actions generally, an independent basis for asserting federal questions or diversity jurisdiction must be shown and except in cases in which the injunction is to operate 'in rem', the court must have personal jurisdiction over the party against whom equitable relief is sought. The rule assumes that the district court already has acquired jurisdiction and that venue is proper." (Emphasis added).

The SEC in this action and presumably in other actions for similar relief is apparently of the opinion that actions asserting violations of Section 10 (b) of the Security Exchange Act of 1934 and Rule 10 b-5 thereunder, are commenced by order to show cause for injunctive relief with notice of the application given to the named defendants. The Commission puts no stress on the filing of the complaint nor the service of the summons and complaint to confer personal jurisdiction upon the Court.

In this particular action the District Court, however unintentionally, in preparing its "So Ordered" Memorandum dated December 31, 1974, proceeded on the same basis. The memorandum begins at 113A:

> "This action was brought on by order to show cause on September 3, 1974 by the Securities and Exchange Commission ("SEC") for injunctive relief and for the appointment of a receiver."

Of course, the Court subsequently refers to the filing of the complaint the morning of the same date that the order to show cause was presented to it for signature on September 3, 1974 (125A).

The Court also finds that the EHG GROUP was given adequate notice of the application for a preliminary injunction under Rule 65 (a) (1) to meet the requirements of due process of law. It bases this conclusion not on the fact that Stroock, Stroock & Lavan, Esqs. were advised by telephone and in person on September 3, 1974, and September 4, 1974, of the application for the temporary restraining order and preliminary injunction. Such service on said attorneys would have been clearly insufficient (Ransom v Brennan, 437 F 2d 513, 518, 519 (5 Cir); United States v Bosurgi, 343 F Supp 815, 817 (S.D.N.Y.).

Nor did the Court rely on a telephone call to the defendant, Ariel Gutierrez, on September 3, 1974, as sufficient notice (130A).

However, the Court asserts that mailing copies of the temporary restraining order and order to show cause to Ariel and Enrique Gutierrez on September 4, 1974, constituted sufficient notice of the hearing to be held on September 13, 1974. The Court relies on Rule 6 (d) of the Federal Rules of Civil Procedure which requires five days notice of motion of the hearing date, plus three additional days under Rule 6 (e) because the notice was sent by mail. Said defendants had at least eight days notice of the hearing which was returnable September 13, 1974.

With respect to Rule 6, of the Federal Rules of Civil Procedure, the Court below overlooked local General Rule 9 (c) (2) of the Southern District of New York which requires ten days notice of motion, to which if is added the additional three days for mailing, brings the requisite notice to thirteen days from September 4, 1974, or September 17, 1974.

In any event, the Court mistates the EHG GROUP argument. There is no quarrel with the number of days notice given. The EHG GROUP position is that no matter the number of days notice given the Court had no jurisdiction of said defendants absent the service of the summons and complaint.

The District Court at one point comes to that conclusion too when it asserts that the preliminary injunction against the EHG GROUP would be void without personal jurisdiction by the Court over said defendants. However, the Court claims personal jurisdiction over said parties because the formal order granting the preliminary injunction was signed on September 24, 1974, five days after the defendants were personally served with the summons and complaint in Puerto Rico on September 19, 1974. The Court disregards the actual fact that the order for the preliminary injunction and the appointment of a receiver was granted at the hearing on September 13, 1974, but not signed until September 24, 1974 because of the problem of appointing a satisfactory receiver.

The Court below is attempting to give retroactive effect to the service of the summons and complaint to make an order originally void because of lack of personal jurisdiction, valid by subsequent service of the summons and complaint. This it may not do because such action is a violation of jurisdictional due process.

It is respectfully submitted that on September 13, 1974 the District Court did not have in personam jurisdiction of the EHG GROUP. Notice of the application for the preliminary

The affidavit of Ariel E. Gutierrez asserts that for

injunction did not confer personal jurisdiction. The reliance by the Court as well as the Commission upon the cases of Securities and Exchange Commission v Dumont Corporation, 49 F. R. D. 342 (S. D. N. Y.) and Plaquemines Parish School Board v United States, 415 F 2d 817 (5 Cir) is misplaced.

In Securities and Exchange Commission v Dumont Corporation, supra, the defendant Pollack deliberately avoided the service of the summons and complaint on six occasions between April 10, 1969 and April 24, 1969, when copies of the summons and complaint were nailed to the door of the defendant's residence in New Jersey and copies thereof mailed to him on April 24, 1969. Such service constituted valid personal service upon the defendant pursuant to New York law (CPLR 308). Out of state service was authorized pursuant to 15 U.S.C. §§ 77 v (a) and 78 a a . Said defendant also refused to accept notice of motion for a preliminary injunction mailed by certified mail to his residence on April 10, 1969, and April 24, 1969, returnable May 6, 1969. The defendant filed no answer to the complaint or motion before the hearing on May 6, 1969 at which he defaulted. On that date the District Court granted the preliminary injunction which was signed the next day.

Such facts are in no way analogous to the present case and are completely inapposite. The EHG GROUP did not avoid or evade service of process. The Commission made no attempt to serve the summons and complaint prior to the return date of the order to show cause.

In Securities and Exchange Commission v Dumont, supra service of process was accomplished before the return date of the motion for a preliminary injunction and the Court had jurisdiction of the person of the defendant prior to the date of the hearing. This is not true in our case.

Nor does Plaquemines Parish School Board v United States, supra, support the opinion of the District Court nor the position of the Commission. It plainly appears that the Court had in personam jurisdiction of the defendant at the time the United States moved for a preliminary injunction.

As stated by the Court at page 824:

> "First, it should be noted that the district court's temporary restraining order and order to show cause, together with the amended complaint, were personally served on the Commission Council and its individual members. These papers fully advised the Commission Council and its members of the nature of the claim against them and of the plaintiff's application for apreliminary injunction." (Emphasis added)

It plainly appears in Plaquemines Parish School Board v United States, supra, thatthe Court had personal jurisdiction of the Commission Council and its individual members, since the amended complaint was personally served on them together with the moving papers for an injunction. That is a far cry from the EHG GROUP situation where service of the summons and complaint was made after the return day of the hearing on the injunction and the granting of same by default on September 13, 1974.

Mullane v Central Hanover & Trust Company, 339 U.S. 306, 315 (1950) quoted by the District Court in its memorandum (128 A) that reasonable notice of the pendency of a proceeding to interested parties meets the constitutional requirements of due process, is not in point. It was not an adversary proceeding requiring personal jurisdiction of the parties by the Court.

The proceeding involved the judicial settlement of accounts by the trustee of a common trust fund under the New York Banking Law, and the sufficiency of notice by publication to beneficiaries known and unknown. The Supreme Court held that notice by publication was sufficient for beneficiaries whose interests or addresses were unknown to the trustee.

However, with respect to known persons the Supreme Court held the notice by publication provision of the New York Banking Law was constitutionally insufficient stating as follows at page 320:

> "We hold the notice of judicial settlement of accounts required by the New York Banking Law § 100-c(12) is incompatible with the requirements of the Fourteenth Amendment as a basis for adjudication depriving known persons whose whereabouts are also known of substantial property rights. Accordingly the judgment is reversed and the cause remanded for further proceedings not inconsistent with this opinion."

In any event the effect of lack of personal jurisdiction over parties to an action was not an issue in said proceeding.

It is a basic principle of law that service of process and jurisdiction of the person are necessary prerequisites to the issuance of an injunction.

In Commercial Security Bank v Walker Bank, 456 F 2d 1352 (10 Cir), the United States appealed from an order of the District Court denying its application to vacate a restraining order entered in an interpleader action. The Appellate Court reversed the order and vacated the restraining order holding at page 1355:

> "We now reach the central issue involved in this appeal, that is, whether the trial court had jurisdiction to enter the order against the United States, when that party had not been served with process and was not in any manner before the

the court. It is axiomatic that before a court may enter a valid decree adjudicating the rights of an individual, that individual must in some fashion submit himself to the jurisdiction of the court or be subjected to the jurisdiction of the court by service of process. If the proceeding is in rem, some appropriate form of notice must be given any individual whose interest in the res is to be adjudicated. Pennoyer v Neff, 95 U.S. 714, 24 L Ed. 565 (1878). It is undisputed that there was no service of process made on the United States and that the United States did not submit to the jurisdiction of the court. Nor was the proceeding below in rem, so as to vest the court with jurisdiction to preserve the res pendente lite."

In Hitchman Coal & Coke Co. v Mitchell, 245 U.S. 229, 234, the Supreme Court of the United States held as follows:

"The final decree of the District Court included an award of injunction against John Mitchell, W.B. Wilson and Thomas Hughes, who while named defendants in the bill were not served with process and entered no appearance except to object to the jurisdiction of the court over them. Under the federal practice, the appearance to object did not bind the parties to submit to the jurisdiction on the overruling of the objection and since the injunction operates only in personam, it was erroneous to include them as defendants."(emphasis by the court).

See, also, Eighth Regional War Labor Board v Humble Oil & Refining Co., 145 F 2d 462, 464 (5 Cir).

There is only one further point to be made on the question of in personam jurisdiction. The District Court in its memorandum treats the application of the EHG GROUP to vacate the preliminary injunction and the appointment of a receiver as an application by them to reconsider the entry of the preliminary injunction and the appointment of a receiver against them (124 A). That was not the application of the EHG GROUP. Said defendants moved to vacate the preliminary injunction and the appointment of a receiver (72A) upon the basis that they were not served with a copy of the complaint and the Commission's application for a temporary injunction until September 19, 1974 (77A). Therefor, the District Court had no personal jurisdiction upon them to grant a preliminary injunction on September 13, 1974.

Under the circumstances, the Court's assertion in its memorandum that any inadequacy concerning the notice given them of the Commission application for a preliminary injunction and the appointment of a receiver, is effectively vitiated because the defendants on November 25, 1974, at the oral hearing of their application had an opportunity to present

any argument against its entry, is without legal effect or merit. The Court still had no jurisdiction in personam on September 13, 1974 and the EHG GROUP did not waive such lack of jurisdiction by their application. Neither Banke v Novadel-Agene Corp., 130 F 2d 99 (6 Cir), cert. denied 317 U.S. 692, nor American Surety Co. v Baldwin, 287 U.S. 156, 168, cited by the Court leads to any different result.

The District Court lacked personal jurisdiction over the EHG GROUP and the preliminary injunction issued against them was void.

POINT II

THE COMMISSION FAILED TO ESTABLISH A PROPER SUFFICIENTLY STRONG PRIMA FACIE CASE AGAINST THE EHG GROUP TO WARRANT THE ISSUANCE OF A PRELIMINARY INJUNCTION AND THE APPOINTMENT OF A RECEIVER AGAINST THEM.

It is the position of the EHG GROUP that the preliminary injunction is void with respect to them because the District Court lacked in personam jurisdiction over the GROUP on September 13, 1974, when the injunction was granted.

The EHG GROUP in no way waives or intends to waive said position by this argument that the Commission failed to present a sufficiently strong case to permit the Court to grant said preliminary injunction against them.

The Court has nevertheless granted a preliminary injunction and appointed a receiver upon the basis that since 1968 all of the defendants including the members of the EHG GROUP have engaged in a course of conduct to convert the assets of the Capital Growth Companies for their own benefit to the detriment of their shareholders by a fraudulent scheme in violation of Section 10 (b) of the Securities Exchange Act of 1934, 15 U.S.C. 78 j (b) and Rule 10 b-5 thereunder 17 CFR 240.10b-5 (113A, 117A).

The members of the EHG GROUP are not and never were officers, directors, shareholders, managers, or in any way associated in a fiduciary capacity with the Capital Growth Group

or the Sheffield Group. There were business dealings between the EHG GROUP and the Capital Growth Group conducted at arms length and in a completely honest and legitimate manner.

The EHG GROUP had no knowledge of the nature of the operations or activities of the Capital Growth Group. What existed between them was a simple business relationship.

The Commission in its complaint artfully by innuendo and suspicion because of the business association of the EHG GROUP with the Capital Growth Group attempts to make the EHG GROUP a member of the conspiracy to violate the security exchange laws of the United States.

The Commission not certain that the allegations of its complaint concerning the EHG GROUP and the Capital Growth Group would be sufficient to make the EHG GROUP part of the conspiracy, added a large dose of malt to the brew it was creating by including an allegation in the complaint concerning Robert L. Vesco and the EHG GROUP which had no connection with and was not properly part of the complaint (13A-14A).

Nor do the papers in support of the Commission's application for a preliminary injunction and the appointment of a receiver meet the standard of proof required with respect to the EHG GROUP. The affidavit of Jerald A. Lanzotti is

based upon information and belief (33A), and alleges as the source of such information and belief documents and testimony obtained by the Commission in its investigation of the matter (33A-34A). Such documents and testimony were not introduced in evidence during the course of the hearing of September 13, 1974. The Commission, however, did include some affidavits and documents as Exhibit "A-J" in support of its application (34A). Most of said exhibits deal with the Capital Growth Group and Sheffield Group, their dealings with shareholders and the inside operations of said companies, and do not involve the EHG GROUP. There is some reference to the business conducted between the Capital Growth Group and the EHG GROUP. (E125-E130, E160, E175-E178, E183-E186).

The complaint and proof submitted by the Commission do not meet the applicable standard of law required forissuing a preliminary injunction against the EHG GROUP.

The Commission has not clearly shown probable success on the merits and possible irreparable injury or sufficiently serious questions on the merits to make them a fair ground for litigation, and a balance of hardships tipping decidedly toward the Commission (Sonesta International Hotels Corporation v Wellington Associates, 483 F 2d 247 (2d Cir)

Certainly, the Commission has not met the requirement laid down by the Supreme Court in Sampson v Murray, 415 U.S. 61, that irreparable harm must be established for all preliminary injunctions.

The complaint and proof offered by the Commission refer to three transactions involving the Capital Growth Group and the EHG GROUP which allegedly constitute violations of Section 10 (b) of the Securities Exchange Act of 1934, 15 U.S.C. 78 j (b), and Rule 10 b-5 thereunder, 17 CFR 240.10 b-5, by the EHG GROUP.

Two of said transactions as alleged in the complaint involve the sale by the EHG GROUP to the Capital Growth Group of 200,000 shares of the EHG GROUP in September 1969 for $2,005,000 in cash (11A), and the subsequent repurchase of said 200,000 shares by the EHG GROUP in September 1972 for $1,300,000 in cash through an alleged intermediary, of which amount the Capital Growth Group supposedly received only $1,000,000 (14A).

According to the affidavit of Ariel E. Gutierrez made in support of the application to vacate the preliminary injunction, the sale of the 200,000 shares was made with the approval of the SEC of Puerto Rico as well as a no-action letter dated August 18, 1969, from the Commission (82A-83A, E201-E202;E243-E247;E248). The shares were repurchased from J.H. Burke who had acquired the shares from the Capital Growth Group. The purchase price was $1,300,000 paid by a check in that amount for which Burke issued a receipt and two letters (84A-85A;E260-E267). Ariel E. Gutierrez asserts he had no knowledge of any letter signed by Burke that he was selling said shares for $1,000,000, nor was such letter delivered to him (85A; E127-E128.).

Of course, the reference to Robert L. Vesco in paragraph 31 of the complaint (13A) is entirely gratuitous. The Commission has never shown any connection between Vesco and the sale of the 200,000 shares by the EHG GROUP to the Capital Growth Group in September 1969, nor the repurchase of said shares by the EHG GROUP in September 1972. The allegations in paragraph 31 have nothing to do with this transaction, and the further allegations in paragraph 32 that "as part of this transaction, McAlpin caused the Capital Growth Companies to resell to Ariel Gutierrez the 200,000 shares of the common stock of EHG which it had acquired in the 1969 transaction" are completely without foundation (13A-14A). Nowhere does the Commission offer proof of such a connection. The affidavit of Jerald A. Lanzotti is just as conclusory as the allegations of the complaint, nor does he attribute to the EHG GROUP any knowledge or participation in the alleged "missing" $300,000. as to which he states McAlpin has refused to testify (41A-42A).

The allegations of paragraph 31 and the effort to tie together Vesco, McAlpin and the EHG GROUP in paragraph 32 are completely inflammatory and prejudicial, and asserted by the Commission without proof for such purposes only.

The fact is that said sale and repurchase of the 200,000 shares were at arms length business transactions and reflect the change in the economic situation between the years 1969 and 1972 not only in Puerto Rico, but in the United States, and on a world wide basis. Many shares of corporations of much greater magnitude than the EHG GROUP show a larger percentage of loss in the value of their shares during the same period than occurred here.

The sole remaining transaction involving the EHG GROUP alleged in the complaint and the supporting affidavit of Jerald A. Lanzotti for the preliminary injunction, relates to the acquisition on December 12, 1969, by Transcaribbean Real Estate Properties (Transcaribbean) a wholly owned subsidiary of Capital Growth Real Estate Fund (Real Estate Fund) and part of the Capital Growth Group, of a 50% interest in four parcels of undeveloped land in Puerto Rico from Condotel, Inc., a member of the EHG GROUP. There is no reference in the complaint (paragraphs 33 through 35) to the price paid for said 50% interest (14A-15A). Nor does the affidavit of Jerald A. Lanzotti make mention of the price (42A-43A).

However, the affidavit of Ariel E. Gutierrez states the purchase price to have been $3,000,000 (90A). This is confirmed by the Accountants' Report of Peat, Marwick, Mitchell & Co. which states that the purchase price was $480,000 cash and the assumption of mortgages on the property of $2,520,000, making a total of $3,000,000 (E-183).

Said 50% interest was repurchased by Condotel, Inc. renamed Golden Beach Apartment Corporation, for $1,600,000 on August 1, 1971, the Real Estate Fund receiving four notes of Golden Beach with due dates extending from December 31, 1971 to December 31, 1974 (15A, 34A).

According to the affidavit of Ariel E. Gutierrez said sum of $1,600,000 represented a profit to the Real Estate Fund of approximately one half million dollars (90A). Concededly, this is a paper profit. This is apparently confirmed by the same Accountants' Report which in Exhibit B-6 shows a deferred profit of $470,000 in connection with the Golden Beach transaction (E-176).

The due dates of each of said notes of Golden Beach were extended for one year by the Capital Growth Group for a consideration of $20,000 which the Commission alleges has not been received by the Capital Growth Group (15A).

The affidavit of Ariel E. Gutierrez asserts that for extending the maturity dates of said four notes, the EHG GROUP paid extension, financing and advisory fees totalling $80,000, including the alleged missing $20,000 which was sent by wire on October 5, 1971, as shown by Exhibit FF (91A, E-311).

The first note of $500,000 with accrued interest totalling $552,500 was paid by the EHG GROUP on November 20, 1972 (Commission Exhibit B-7, E 185).

Once again, the picture presents a legitimate business deal with a profit to the Capital Growth Group which unfortunately because of hard times prevented the EHG GROUP from making good all of the notes on the due dates.

There is no evidence of fraud or deceit on the part of the EHG Group. There is no conspiracy in which it was a part to the deprivation of shareholders of the Capital Growth Group.

The proof of the Commission fails to show that the EHG GROUP participated in any acts or practices which constitute violations of Section 10 (b) of theExchange Act and Rule 10 b-5 thereunder, whatever the proof may be with respect to the Capital Growth Group and the Sheffield Group.

The principles enunciated by this Court in Securities and Exchange Commission v Manor Nursing Centers, Inc., 458 F 2d 1082 (2 Cir) have no application to the EHG GROUP. They were not insiders or principals of the Capital Growth Group and the Sheffield Group. They were not in any fiduciary relationship with the directors, officers or shareholders of said companies. They had no knowledge of what was happening behind the corporate walls of the Capital Growth Group or the Sheffield Group. They were not selling shares of the Capital Growth Companies to innocent victims. The conclusion of the District Court that good faith dealings constitute no defense to this action by the Commission is in error.

It was a clear abuse of discretion on the part of the Court below to grant the preliminary injunction against the EHG GROUP. It was a further improper exercise of discretion by the Court when it denied the application of the EHG GROUP to vacate the preliminary injunction and the appointment of a receiver.

CONCLUSION

THIS COURT SHOULD REVERSE THE ORDER OF THE DISTRICT COURT DENYING THE APPLICATION OF THE EHG GROUP TO VACATE THE PRELIMINARY INJUNCTION AND THE APPOINTMENT OF A RECEIVER AND SAID APPLICATION SHOULD BE GRANTED.

Respectfully submitted,

IRVING RADER
Attorney for Defendants,
EHG GROUP

Gilberto Mayo and
Rafael Cuevas,
Co-Counsel

STATE OF NEW YORK)
: SS:
COUNTY OF RICHMOND)

ROBERT BAILEY, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10.02. That on the 13 day of March, 1974 deponent served the within Brief upon Sec. of Appeals Div.

attorney(s) for appellee

in this action, at 500 North Capitol St
Wash, D C. 20549

the address designated by said attorney(s) for that purpose by depositing 3 true copies of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.

ROBERT BAILEY

Sworn to before me, this
13 day of March

WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1976

AFFIDAVIT OF PERSONAL SERVICE

STATE OF NEW YORK,
COUNTY OF RICHMOND ss.:

EDWARD BAILEY being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 13 day of March, 19 73 at No. 26 Broadway-26 Fed. Plaza deponent served the within Brief upon Sec'y Regional Office - Barrett, Smith, Seligson & Simon the appellee herein, by delivering a true copy thereof to h personally. Deponent knew the person so served to be the person mentioned and described in said papers as the appellee therein.

Sworn to before me,
this 13 day of March 19 73

Edward Bailey

WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1973